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Letter Ruling 98-19: Eligibility of an Electing Small Business Trust for Inclusion in an S Corporation Composite Return

November 18, 1998

You request a letter ruling allowing the ***** ("the S Corporation") to include its non-resident Electing Small Business Trust ("ESBT") shareholders in the composite tax return that it files as agent for its qualified electing non-resident S shareholders.^[1] In tax year 1997, 16 of the S Corporation's 69 shareholders were ESBTs. The only asset held by the ESBTs is stock in the S Corporation.

Discussion

Under Massachusetts Regulation 830 CMR 62.5A.1(12)(g), an S corporation may file a composite return as an agent for its qualified electing non-resident shareholders. A shareholder is a qualified electing shareholder only if the shareholder meets several criteria, including a requirement that the shareholder be either a non-resident individual or the estate or trust of a deceased non-resident shareholder. See 830 CMR 62.5A.1(12) (f)(1) and (g).

Although an ESBT is neither an individual nor the estate or trust of a deceased individual, an ESBT shareholder has many of the tax attributes of a individual that owns shares in an S corporation. Like an individual, an ESBT has a separate tax identification number, includes in income its pro rata share of the S corporation income, and pays tax at the trust level on its pro rata share of S corporation income for both Massachusetts and federal purposes. G.L. c. 62, § 10; IRC § 641(d).^[2] Thus, it is appropriate to treat an ESBT shareholder in the same manner as an individual shareholder for purposes of being included in a composite return.

Conclusion

We rule that the S Corporation's shareholders that are ESBTs may be included in a composite return, provided that the ESBT shareholder otherwise falls within the definition of a qualified electing shareholder under 830 CMR 62.5A.1(12)(f)(1) and (g).

Very truly yours,

/s/Bernard F. Crowley, Jr.

Bernard F. Crowley, Jr.
Acting Commissioner of Revenue

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[\[1\]](#) Under 830 CMR 62.5.1(11), a non-resident trust is defined as “[a] trust, other than a corporate trust, deriving Massachusetts source income and which is [either] (a) a trust under the will of a decedent who was a non-resident at the time of death; (b) a trust all of whose trustees are non-residents; or (c) a trust all of whose grantors are non-residents; [and] is subject to Massachusetts income taxation on its Massachusetts source income determined as if the trust were a non-resident individual.

[\[2\]](#) When income is distributed by an ESBT to the beneficiary of that ESBT, there is no additional tax since the income was previously taxed at the trust level.